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DEFENSE CONTRACTING

Progress Made in Implementing Defense Base Act Requirements, but Complete Information on Costs Is Lacking

Statement of John K. Needham, Director
Acquisition and Sourcing Management Issues



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Why GAO Did This Study

The Defense Base Act (DBA) requires U.S. government contractors and subcontractors to buy workers' compensation insurance for employees working overseas, and the cost of this insurance is then passed on to the government. The Department of Labor oversees the claims process and ensures contractors are aware of DBA insurance requirements. Given the large number of contractor personnel working in Iraq, concerns have been raised over the cost of workers' compensation insurance provided under DBA. Since the Iraq conflict began in March 2003, federal agencies have issued contracts for Iraq reconstruction and to support deployed forces. The Department of Defense (DOD) recently reported it alone has 163,591 contractor personnel working in Iraq.

Based on GAO's 2005 report on DBA insurance, Congress directed DOD to address challenges identified. This testimony is based on the 2005 report and GAO's analysis of recent agency efforts. As requested, it provides an update on (1) DOD's efforts to reduce DBA insurance rates; (2) DOD's ability to calculate its total DBA insurance costs; and (3) the progress toward addressing prior DBA implementation challenges.

In preparation for this testimony, GAO reviewed related reports to identify agency efforts to address prior findings and interviewed officials from DOD, State, Labor, and USAID. GAO discussed this testimony with agency officials.

To view the full product, including the scope and methodology, click on [GAO-08-772T](#). For more information, contact John Needham at (202) 512-4841 or needhamjk1@gao.gov.

DEFENSE CONTRACTING

Progress Made in Implementing Defense Base Act Requirements, but Complete Information on Costs Is Lacking

What GAO Found

While DOD has taken steps to reduce DBA insurance rates through the U.S. Army Corps of Engineers' (Army Corps) single-insurer pilot program, it has not yet implemented similar efforts departmentwide. GAO previously reported that eight DOD prime contractors paid from \$10 to \$21 per \$100 of salary cost, a rate that was significantly higher than the rates paid by State and USAID contractors—\$2 to \$5 per \$100 of salary cost—through the agencies' respective single-insurer programs. Since the Army Corps implemented its single-insurer program in December 2005, its insurance rates have decreased from what DOD was previously paying. For example, the Army Corps is now paying from \$3.50 to \$7.25 per \$100 of salary cost for service and construction contracts.

DOD continues to lack reliable aggregate data on the total cost of DBA insurance. Based on GAO's 2005 report, Congress directed DOD to identify methods to collect data on DBA insurance costs. While State, USAID, and Army Corps can obtain aggregate DBA cost data for their respective single-insurer programs, DOD reported that it has not collected this data departmentwide. As GAO has previously reported, agencies can analyze financial data to leverage their buying power, reduce costs, and better manage suppliers of goods and services.

Labor officials told GAO they have taken steps to address several of the DBA insurance implementation challenges GAO identified in its 2005 report. For example, GAO found there was uncertainty among agency officials regarding when DBA insurance was required as well as problems in processing claims and monitoring compliance. Labor officials told GAO they have been receiving fewer questions after holding seven seminars through 2006 on DBA insurance for contractors, insurance companies, agency officials, and attorneys in order to clarify DBA insurance requirements. While Labor officials also noted improvements in processing insurance claims, they still face challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

Mr. Chairman and Members of the Committee:

Thank you for inviting me here today to discuss the Defense Base Act (DBA)¹ and its implementation in Iraq. DBA requires U.S. government contractors and subcontractors to buy workers' compensation insurance for employees working overseas. The cost of this insurance is then passed on to the government. Given the large number of contractor personnel working in Iraq, concerns have been raised over the cost of workers' compensation insurance provided under DBA. Since the Iraq conflict began in March 2003, the departments of Defense (DOD) and State, the U.S. Agency for International Development (USAID), and other federal agencies have issued contracts for Iraq reconstruction and to support deployed forces. DOD recently reported it alone has 163,591 contractor personnel working in Iraq. These personnel would be subject to DBA requirements unless covered by an exception.²

In April 2005, we reported on cost and implementation issues associated with DBA.³ Based on a review of DBA insurance rates for contracts representing 69 percent of U.S.-appropriated contracting dollars awarded for ongoing work as of May 2004, and interviews with officials from selected contractors, DOD, State, Department of Labor, Department of Justice, and USAID, we found

- the total cost of DBA insurance to the government or the extent to which Iraq reconstruction funds were being spent on DBA insurance could not be calculated due in part to the difficulty in gathering data on the large number of contractors and the multiple levels of subcontractors performing work in Iraq;
- wide variations in the amounts federal agencies were paying for DBA insurance, ranging from \$2 to \$21 per \$100 of salary;
- several challenges in implementing DBA insurance requirements for Iraq, such as the lack of clarity in DBA insurance requirements, delays in processing claims, and difficulty in monitoring contractor compliance.

¹ 42 U.S.C. 1651-1654.

² These exceptions include contracts approved or financed by the Development Loan Fund, contracts exclusively for materials or supplies, or waivers issued by the Secretary of Labor with respect to any contract, work location, or class of employees.

³ GAO, *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues*, [GAO-05-280R](#) (Washington, D.C.: April 29, 2005).

As a result of our work, Congress directed DOD to work with other agencies to address these challenges.

My statement today is based on our 2005 report and our analysis of recent agency efforts. I will provide an update on (1) DOD's efforts to reduce DBA insurance rates; (2) DOD's ability to calculate its total DBA insurance costs; and (3) the progress toward addressing prior DBA implementation challenges. In preparation for this testimony, we reviewed reports related to DBA insurance to identify agency efforts to address our prior findings and interviewed officials from DOD, State, Labor, and USAID. We conducted our work from April to May 2008, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our analysis of recent agency efforts with agency officials and made technical corrections where appropriate.

Summary

DOD and Labor have made progress in addressing challenges we identified in our April 2005 report, but several still remain. While DOD has taken steps to reduce DBA insurance rates through the U.S. Army Corps of Engineers' (Army Corps) single-insurer pilot program, it has not yet implemented similar efforts departmentwide. Through its pilot program, the Army Corps has lowered its DBA insurance rates from what DOD had previously paid. While State, USAID, and Army Corps can obtain aggregate DBA cost data for their respective single-insurer programs, DOD reported that it has not collected this data across the department. We previously reported that the lack of such data prevents DOD from calculating the total cost of DBA insurance or the extent to which Iraq reconstruction funds were being spent on DBA insurance. In addition, while we previously reported several challenges in implementing DBA insurance requirements in Iraq, Labor officials told us that several of these challenges have since been addressed—requirements are clearer and claims processing has improved. However, Labor still faces challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

Background

Congress enacted DBA in 1941 to provide workers' compensation protection to employees of government contractors working at U.S. defense bases overseas. Subsequent amendments to DBA extended coverage to other classes of government contractor employees. The

insurance required under DBA provides employees with uniform levels of disability and medical benefits or—in the event of death—provides death benefits to eligible dependents. Under DBA, contractors working in Iraq, including all levels of subcontractors, are required to obtain DBA insurance for all employees, including foreign nationals. The cost of DBA insurance premiums is then passed on to the government. State, USAID, and the Army Corps have single insurer programs that require all contractors performing work overseas to purchase DBA insurance from a specified insurance carrier at a set rate. Labor oversees the claims process, provides dispute resolution services, and is responsible for ensuring that contractors are aware of the requirement to purchase DBA insurance for covered employees.

DOD Has Taken Steps to Reduce Insurance Costs, but Has Not Yet Implemented Similar Efforts Departmentwide

While DOD has taken steps to reduce DBA rates since 2005 through the Army Corps' single-insurer pilot program, it has not yet implemented similar efforts departmentwide. We previously reported that eight DOD prime contractors paid from \$10 to \$21 per \$100 of salary cost, which was significantly higher than the rates paid by State and USAID contractors—\$2 to \$5 per \$100 of salary cost—through the agencies' respective single-insurer programs. The following example illustrates the impact of these rates on cost. We reported in July 2005 that security employees providing protection to civilians in vehicle convoys could earn from \$12,000 to \$13,000 per month.⁴ Assuming a DBA insurance rate of \$10.30 per \$100 of salary cost⁵ and that security employee salaries cited in our July 2005 report have remained the same, the contractor could bill the government between \$1,236 and \$1,339 per security employee per month. In addition, DOD reported in April 2008 that it had 12,258 security contractors in Iraq as of December 31, 2007. After receiving complaints from companies doing business in Iraq that the rates for this mandatory insurance had increased precipitously, DOD officials asked the Army Corps to initiate a single insurer pilot program for DBA insurance covering all Army Corps contractors and subcontractors performing work overseas. The pilot program was in place from December 2005 until March 2008 and was subsequently extended through September 2008. Army Corps and DOD officials told us a contract will be awarded in September 2008 for a

⁴ GAO, *Rebuilding Iraq: Actions Needed to Improve Use of Private Security Providers*, [GAO-05-737](#) (Washington, D.C.: July 28, 2005).

⁵ This rate is based on what State and the Army Corps currently pay under their single insurer programs to insure security personnel.

DOD Lacks Reliable Aggregate Data on Total DBA Insurance Costs

permanent single-insurer program. While USAID's current rate for DBA insurance is still the lowest at \$1.58 per \$100 of salary cost, the Army Corps DBA insurance rates have decreased from those paid by DOD prior to the Army Corps' single-insurer program. For example, the Army Corps is now paying from \$3.50 to \$7.25 per \$100 of salary cost for service and construction contracts.

DOD continues to lack reliable aggregate data on the total cost of DBA insurance. While State, USAID, and Army Corps can obtain aggregate DBA cost data for their respective single-insurer programs, DOD reported that it has not collected this data departmentwide. We previously reported the lack of reliable aggregate data to calculate the total cost of DBA insurance to the government or the extent to which Iraq reconstruction funds were being spent on DBA insurance was due, in part, to the difficulty in gathering data on the large number of contractors and multiple levels of subcontractors in Iraq. In response to our report, Congress directed DOD to identify methods to collect data on DBA insurance costs. We have previously reported that agencies can analyze financial data to leverage their buying power, reduce costs, and better manage suppliers of goods and services.⁶ As recently as last year, DOD still was not collecting aggregate data on its DBA insurance costs and reported that such data collection efforts would be expensive and would divert already limited contracting resources without any clear benefit to the procurement process. However, a recent Army Audit Agency report⁷ indicates that the Army was at risk of paying more than necessary for DBA insurance under its LOGCAP contract,⁸ showing DOD still has challenges managing these costs.

⁶ GAO, *Defense Acquisitions: Tailored Approach Needed to Improve Service Acquisition Outcomes*, [GAO-07-20](#) (Washington, D.C.: Nov. 9, 2006).

⁷ U.S. Army Audit Agency, *Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program, Audit of Logistics Civil Augmentation Program Operations in Support of Operation Iraqi Freedom (Project A-2005-ALS-0340.000)*, *Audit Report: A-2007-0204-ALL*, Sept. 28, 2007.

⁸ The Army's Logistics Civil Augmentation Program (LOGCAP) provides logistics and engineering services, such as food preparation, laundry, housing, and construction in support of contingency operations.

Labor Reports Improvements to Prior DBA Implementation Challenges

Labor officials told us they have taken steps to address several of the DBA insurance implementation challenges we identified in our April 2005 report. These included the lack of clarity in DBA insurance requirements, delays in processing claims, and difficulty in monitoring contractor compliance. For example, we found there was uncertainty among agency officials regarding whether (1) previously granted waivers by Labor for DBA insurance were still valid, (2) the grants process is required to follow DBA insurance requirements, and (3) DBA applied in cases where non-U.S.-appropriated-funds were mixed with U.S. appropriations. In addition, we found that the processing of claims had been delayed due to language barriers and the difficulty in obtaining medical and other personal information. Further, Labor could not verify that every contractor and subcontractor working in Iraq had purchased DBA insurance.

According to Labor officials, they have held seven seminars through 2006 on DBA insurance for contractors, insurance companies, agency officials, and attorneys in order to clarify DBA insurance requirements. Labor officials noted that these efforts to clarify DBA insurance requirements have led to a significant reduction in phone calls, e-mails, and other DBA inquiries. Furthermore, Labor officials told us that State and DOD's recent revisions to their regulations or policy memos should help to clarify when DBA insurance requirements apply. These officials also reported that the claims process has improved as claims forms and other insurance information have been translated into Arabic and that two out of the three insurance companies have hired Arabic speaking employees and stationed them in the Middle East. Lastly, Labor officials told us that while prime contractors have generally been compliant in purchasing DBA insurance, they still face challenges in verifying that subcontractors in Iraq have obtained DBA insurance.

Concluding Observations

Considering the unprecedented number of contractors and subcontractors involved in Iraq reconstruction efforts and supporting deployed forces, the U.S. government is likely spending considerable sums on DBA insurance. While DOD has taken steps through the Army Corps' single-insurer program to reduce its DBA rates, it does not know what it is spending departmentwide on such insurance. Without this information, DOD is limited in its ability to make fully informed decisions regarding its options for minimizing departmentwide DBA insurance costs. Furthermore, the lack of detailed information on these costs makes it difficult for Congress to conduct full oversight of reconstruction funds.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other Members of the Committee may have at this time.

Contacts and Acknowledgments

For further information regarding this testimony, please contact John Needham at (202) 512-4841 or (needhamjk1@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this product. Staff making key contributions to this statement were John Neumann, Assistant Director; Jeffrey Hartnett; Greg Campbell; Sarah Jones; Tara Copp; and John Krump.

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